



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

IMMEDIATE FUTURE OF THE EXCESS PROFITS TAX

By T. S. ADAMS

Yale University

In discussing this subject I make one assumption and state five premises which represent in my opinion not only facts, but the pivotal and controlling facts. The assumption is that under existing conditions there is no excuse for immediate reduction of the tax revenue. The facts or premises referred to are as follows:

I. THE FACTS

1. There is an imperative need for immediate simplification in the system of internal revenue taxes. The unvarnished truth is that the income and profits taxes are so heavy and so intricate that a sufficient number of auditors and experts cannot be secured by the government to audit, assess, and settle old claims as fast as new claims are created.

2. The old tax claims must be cleared up and definitely settled. At present the taxpayer never knows when he is through. New rulings cause old returns for a number of years back to be re-examined and reopened. Many of the largest tax returns for 1917, the first year of the war, have not been audited. The Commissioner of Internal Revenue estimates that a thorough audit of these old assessments would result in additional revenues of many hundreds of millions of dollars, positively more than a billion dollars. These old claims should be cleared up not only for the revenue which they represent, but to give that certainty to the taxpayer without which the development of industry and business must be seriously impeded.

3. These old claims arise chiefly under the income and profits taxes. These are the huge pillars of our financial temple. At present they are seriously awry. The excess profits tax does not apply to individual business men, partnerships, or personal service corporations; it is confined to a fraction of the corporations of the country. The income tax on the other hand, so far as the heavy surtaxes are concerned, does not apply to the undistributed profits of corporations. A partnership (or the members thereof) may pay hundreds of thousands of dollars more taxes than the owners of the business would pay if it were in corporate form. *Per contra* a given corporation may pay indefinitely larger taxes than its immediate competitors organized as partnerships. J. P. Morgan & Company is a partnership, but many of its principal competitors are corporations. Macy & Company of New York has been

until recently a partnership; but John Wanamaker, Gimbel Brothers, and most of the New York department stores are corporations. The taxes upon the two forms of business organization may differ indefinitely. We have two systems of business taxation, whereas we should have but one.

4. Whatever the virtues and excellencies of the excess profits tax, it cannot persist as a partial tax applicable only to a portion of the corporations of the country. If the underlying principle is sound it should be applied to all business concerns capable of earning "excess profits."

5. Whatever the virtues of the income tax, it cannot persist with its heavier rates applicable only to individuals, partnerships, and non-corporate taxpayers. These conclusions seem to me practically self-evident.

II. IMMEDIATE PROPOSALS

If the preceding statement of facts represents a correct diagnosis of the situation, we must either extend the excess profits tax to cover all forms of business enterprise, or abolish it and subject corporations to a full-fledged income tax. The latter, I believe, is the only practicable alternative. The essential reason for this conclusion is found in the fact that the excess profits tax imposes upon the administrative machine a burden too heavy to be successfully carried. The excess profits tax applies to those earnings or profits in excess of a normal return. Whether this normal return be computed upon the basis of past profits, invested capital, or both, it can only be determined safely after close study of individual cases. As stated above, the government cannot secure the requisite number of trained auditors to keep pace with the multiplying assessments. If for no other reason, the excess profits tax must be repealed in order to prevent an administrative log jam.

But it will not suffice merely to abolish the excess profits tax. Corporations, in order to be placed upon something like an equality with individuals and partnerships, must bear an additional tax roughly equivalent to the surtaxes on undistributed profits paid by sole proprietors, the members of partnerships, and the stockholders of personal service corporations. This additional tax should apply only to undistributed profits. Distributed profits should be treated as a deduction after the manner of the excess profits or war profits credit. They should be exempt because they are subject to the normal tax as part of the corporate earnings, and to surtaxes as part of the incomes of the individual stockholders. In general this proposal is designed to

place corporations and partnerships upon an equality. To accomplish this end I should recognize a constructive or *pro forma* declaration of dividends for purposes of taxation, without requiring the cash to be actually distributed. This would permit a corporation to place itself upon an equality with its non-corporate competitors if it so desired, while retaining such part of its net income as prudence suggested should be used in extensions or development.

The proposal at this point is important enough to illustrate in some detail. The normal tax upon individuals is 8 per cent and upon corporations 10 per cent. Incidentally I would equalize this by leveling up, and make the normal tax in both cases 10 per cent. Then I should place an additional tax of say 20 per cent upon the undistributed profits of the corporation; but if the corporation preferred, it would be permitted to issue either a stock dividend or what might be called a "constructive dividend" or "certificate of interest," which would bring about the taxation of its undistributed profits in the hands of the stockholders and thus relieve the corporation of the additional tax while at the same time it left the funds in the corporation's hands for use in the business. The legality or constitutionality of such a law would probably be questioned. But I see no reason to believe that the courts would interfere with a provision of this kind when its adoption is entirely voluntary on the part of the corporation. In any event, it could easily be provided, if either the stock dividend or the proposed "constructive dividend" is held to be exempt from taxation to the stockholders, that the corporation should be subject to the additional tax on undistributed profits.

An additional tax of 20 per cent would go far to replace the excess profits tax. It might yield quite as much as the present excess profits tax. We must remember in this connection that while the aggregate corporate income for 1919-1920 will probably fall considerably below the high war levels of 1916-1918, the invested capital of the corporations—upon which the exemption or deduction depends—has been steadily and rapidly increasing. Furthermore, corporations are rapidly acquainting themselves with methods of lawful evasion, particularly the substitution of preferred stock for bonded or other indebtedness.

It is time to abandon the excess profits tax, not only because it is too complex and discriminatory in its application, but because it is losing its productivity.

As an essential part of the practical plan which I am proposing, Congress should authorize the Commissioner of Internal Revenue, or a tax board, to make final settlements of all existing tax claims. Noth-

ing can be more important than this from every practical standpoint. These claims fill the business man with apprehension and doubt. A congressional mandate to clear them up would in my opinion be a blessing to the administrative authorities. They represent in addition a vast source of revenue. There is little justification for the adoption of new taxes, or the continuation of obviously imperfect old taxes, while there are hundreds of millions of back taxes still to be collected.

In conclusion, it is desirable to add that the conclusions which I have expressed are purely personal.